The cash flow statement's component effect on Management Performance in firms enlisted in Tehran Stock Exchange

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ABSTRACT

Important information is broadcasting through cash flow statements which affect the judgments and decisions of investors and also are effective in creating company profitability and assessing management performance. Thus, in the present research we want to find an answer for the following question: Are cash flows resulting from the cash flow statement's component affective over return on assets which is among criteria to assess management performance? The statistical society for the present research entail 138 firms enlisted in Tehran Stock Exchange that has been investigated during a time period of 5 years between 2008 and 2012. Ti test the hypotheses we have used linear regression model and research findings showed that there is a negative and meaningful relationship between cash flows resulting from investment return and the interest paid to finance, and also between cash flows resulting from income tax and cash flows resulting from investment activities and return on assets. Also there is no relationship between cash flows resulting from operational activities, and financing activities and return on assets.

1. Introduction

Economic and financial relationships among humans started from the start of his life and creation in all exchanges. These relations were existent in its simple form in primitive societies. Gradually small communities were formed. Today nobody can deny the very sensitive and key role of big and modern companies in economic structure of the countries. These companies consume a great deal of economic resources of the country (such as capital, workforce, raw material, and managerial workforce), as the main bases of economy in countries. On the contrary regarding the amount of production and sales, they have a very important role in development and economic enhancement. Therefore, it should be pointed out that, several factors affect the management performance, performance of companies, controlling, and assessing them. One of the most important factors is the effect of presenting some information prepared through financial reporting. Financial reporting is the foundation on which capital appropriation flow has been founded. It is clear that an efficient flow of capital appropriation is necessary for economic health and the enhancement of yield and encouraging the innovations. Also this can prepare an efficient and fluid market for bonds exchange and exchanging credits. Financial reporting categorizes certain information about a company regarding the management's outlook and presents it meaningfully for the users. And the investors, potential creditors and their consultants use it as a basis for decision making to appropriate capital. Cash flow statement is considered as one of the main financial statements that have been considered as obligatory to be presented based on accounting standards. This statement entails information about cash receipts and payments during the fiscal year which help the users in predicting future cash flows. Based on what was said cash flow statement and output information of each of its parts can affect management efficiency rate and as a result firm's performance (Ahmadi, 2012).

2. Materials and Methods

2.1. Research theoretical framework

Financial reporting is one of the information resources needed by those who tend to control, assess, and make decisions about activities in business units. These individuals should integrate the information prepared through financial reporting with the related information from other information resources about general and economic conditions for decision making,

performance assessment and assessing the effective and efficient management to carry out their tasks better (FSSB, 1978). Several factors affect management performance, firms' performance, assessment and control of them. One of the most important factors is the effect of information prepared through financial reporting. Financial reporting categorizes certain information of a company regarding management's outlook and presents it to the users meaningfully (Pourbagheri, 2009).

Cash flow statement, as one of the principal financial statements, is one of the most efficient reports to reflect the performance of a business unit regarding cash and present information needed about creating and consuming cash to the users of financial statements. Cash is one of the important resources in each economic unit and making a balance between accessible cash and cash needs is considered as the most important factor in economic safety of each business unit. Based on different outlooks, different models have been proposed to present this financial statement and each of the models have different comprehensibility and reliability regarding the amount of precision and transparency in presenting information and different effects on users regarding decision making and performance assessment of business units (Dastgir and Khodabandeh, 2005).

Firms' performance is a criterion to measure the amount of achievement of organizational goals and includes financial and operational performance. Effective factors on firms' performance can de divided into two groups. One group is categorized as relating to the structure, mechanisms, and several factors present in the company and it affects performance directly such as management performance, internal controls, corporate governance and etc. The other category is related to the type of performance of the company, using methods and tools in announcements, the effect of presenting information resulted from financial statements, feedback of users of the information and etc (Tilekani, 2007).

Based on the above, one of the factors affecting firm's performance is management performance, which is one of the important management tasks is to control Operating assets. If additional assets applied in the operation it will cause increasing operating costs. Return on asset by controlling costs, net profit and sales volume causes managers to carefully plan the deployment of operational assets. In fact, the return on asset is the basic scale used to evaluate the management performance (Rezaei, 2013).

Therefore, management performance evaluation is very important. To assess the management performance, the owners use different tools and scales. At any period of time, certain measures proposed and each beneficiary use these scales according to his vision to evaluate the performance of managers. So the owners are always looking for the scales using them cause evaluate management performance and efficiency in the best way (Namazi, 2010).

According to the different models of cash flow statements and the effect of reporting type on management efficiency and effectiveness and also the rate of return on assets is one of the measure's scale for management performance specially investing centres, present research has been carried out to investigate the effect of the cash flow statement's component on the return on assets of firms enlisted in Tehran Stock Exchange.

2.2. Previous Research

The results of a research by Martin and Meyeres (2006) showed that the financial statement mentioned and its ratios were an appropriate index to show the health and success of the company and managers and financial agents can rely on these ratios in showing the financial status of a company.

Reybern (2007) studied about cash resulting from operational activities accompanying cash flow statement and accruals accompanying stock return. According to Reybern, regarding the fact that the primary and main interest of the users is the figures which show the performance of an entity, the main focus of the research mentioned should be on operational cash flow, instead of sum of cash flow. Results of the research by Reybern showed that there exists and accordance both between cash resulting from operational activities and return on equity and between accruals and the return of this companionship.

Wilson (2009) studied about the information content of the components of cash flow statements on information content of cash earning. This research wanted to investigate whether the components of cash flow statements have had information content or not? Also do they affect cash earnings? Wilson found out in his research that there is coordination between the components of cash flow statements and cash earnings. The result of his research showed that the related components do contain information load.

Mehrani and Mehrani (2003) studied the relationship between profitable ratios and stock return in Tehran Stock Exchange. This research was about the relationship between stock return and profitability ratios including return of assets and return of equity. The research results showed that some ratios such as ROA and ROE have a meaningful relationship with stock return and also some changes of some of the variables such as equity and return of assets can not predict the changes in return of stock solely.

Sardarizadeh (2012) studied the relationship between net cash in each of the stages of cash flow statement and the ratio of price to earning per each share. The goal of this research was to find out whether net cash resulting from operational activities, return of investment and interest paid to finance, income tax of investment activities and financing activities can affect the ratio of price to earning per each share of the company or not? The results showed that the effect of cash flows resulting from operational activities and investment activities on the earnings of each share was negative and the effect of cash flow resulting from investment return and interest paid to finance on the variable mentioned was positive. Also the effect of cash flows resulting from income tax and financing activities on the ratio of price to earnings per share has been meaningless.

2.3. Research hypotheses

In the present research and based on the literature and theoretical foundations, the following hypotheses were devised.
H0: The cash flow statement's component effect management Performance.

1- Cash flows resulting from operational activities affect return of assets.
2- Cash flow resulting from return of investments and interest paid to finance affects return of assets.
3- Cash flows resulting from income tax paid affect return of assets.
4- Cash flows resulting from investment activities affect return of assets.
5- Cash flows resulting from financing activities affect return of assets.

2.4. Research method

In order to select our statistical sample, the following conditions were taken into consideration:
To observe the comparability, the fiscal year was decided to be at March 20. During research period, the companies should not have had any type of activity stop and they should not have changed their fiscal year; all information needed about the companies should be accessible to carry out the research, and The companies selected should not be among banks and financial entities (investment companies, financial intermediaries, holding companies, and leasing). By considering the research limitations mentioned above, 138 companies were chosen for the time period between the years 2008 and 2012 and formed our sample.

In this research and regarding the effect of cash flow statement on return of equity and return of assets being tested, the dependent variable of the research was return of equity and return of assets. To calculate these variables, we used multiple-regression models as follows:

Model1:

$$ROA_{i,t}=\beta_1 CFO_{i,t}+\beta_2 CFIR\&SF_{i,t}+\beta_3 PT_{i,t}+\beta_4 CFI_{i,t}+\beta_5 CFF_{i,t}+\beta_6 SIZE_{i,t}+\beta_7 LEV_{i,t}$$

$ROA_{i,t}$ = return of assets of firm i in the year t
$CFO_{i,t}$= operational cash flows of firm i in the year t
$CFIR\&SF_{i,t}$= cash flows of return of investments and interests paid to finance for firm i in the year t
$PT_{i,t}$= paid tax of firm i in the year t
$CFI_{i,t}$= cash flows of investment of firm i in the year t
$CFF_{i,t}$= cash flows of finance of firm i in the year t

Also in this research and based on the researches carried out in Iran, the following variables were considered as control variables:

* **Firm size:** it can be obtained from the natural logarithm of sum of assets at the end of the period. Zimmerman (1983) stated that bigger companies apply more conservatism since they have more political sensitivity (Theory of Political Cost). In the present research, following what has been done in previous studies; we can use two variables as the criteria for firm size. Drashid and Zhang (2003) used natural logarithm of total assets at the end of the period and Zimmerman (1983) used the logarithm of total sales income as the representatives for firm size. But in this research we have used natural logarithm of total assets for firm size (Cano-Rodriguez, 2011).
* **Financial leverage:** this variable is gained by dividing total liability to total assets at the end of the period. Accounting methods are related with financial leverage because one of the criteria noticed by the creditors (in Iranian banks) is the debt ratio of companies. Thus, the higher debt ratio, there would be less tendency for the companies to use conservative methods. Therefore, it is expected that firms' managers apply less conservatism in their financial statements in order to reduce the probability of lack of acceptance of loan demands and to avoid incurring higher interest rates (Hassas Yeghaneh and Shahryari, 2010).

The following table shows the symbols and names of variables.

Table 1: Abbreviation and name of variables selected in the research

Symbol	Variable name
ROA	Return of assets
CFO	Cash flows resulting from operational activities
CFIR*SF	Cash flows resulting from investment return and interest paid to finance
PT	Cash flows resulting from paid income tax
CFI	Cash flows resulting from investment
CFF	Cash flows resulting from finance
SIZE	Firm size
LEV	Leverage

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3. Results and discussion

Table 2: Results of descriptive analysis

Variables	ROA	CFO	CFIR*SF	PT	CFI	CFF	SIZE	LEV
Observations	690	690	690	690	690	690	690	690
Mean	0.096	0.110	-0.066	-0.015	-0.038	0.017	13.327	0.645
Std. Dev.	0.122	0.121	0.061	0.018	0.076	0.093	1.774	0.251
Skewness	-0.019	0.374	-0.781	-1.95-	-0.759	0.845	-1.914	0.795
Minimum	0.340-	-0.408	-0.346	-0.13-	-0.491	0.573	0.000	0.000
Maximum	0.491	0.579	0.368	0.000	0.382	0.713	18.549	0.977

To study the normality of variables and residuals we used Kolomogorov-Smirnov's test. If the probability amount related to this test is more than 0.05, we can approve the normality of the distribution of variables with %95 assurance. On the contrary, the results of this test in table 3 showed that all dependent variables of the research have had a normal distribution. As it can be seen, the amount of probability of each of the variables is more than 0.05. Thus, we can test the data through a parametric test.

Table 3: Kolomogorov-Smirnov's test to measure data normality

Variables	ROA	CFO	CFIR*SF	PT	CFI	CFF	SIZE	LEV
Kolmogorov-Smirnov Z	1.379	1.254	2.616	5.197	4.054	2.828	1.040	1.111
Sig.	0.089	0.104	0.000	0.000	0.000	0.000	0.230	0.121

Pearson's correlation matrix is a test utilized to determine the amount of correlation between the data. For example, in table 4 in assurance level of %99, there is a positive and meaningful relationship between return of assets and cash flows resulting from operational activities. This relationship has resulted with a correlation coefficient of (0.420) through Pearson's correlation test and shows that there is a positive relationship between return of assets and cash flows resulting from operational activities with an amount of %42.

Table 4: Correlation matrix

Variables	ROA	CFO	CFIR*SF	PT	CFI	CFF	SIZE	LEV
ROE								
ROA	1							
CFO	0.420**	1						
CFIR*SF	-0.393**	-0.480**	1					
PT	-0.409**	-0.427**	0.468**	1				
CFI	-0.207**	-0.396**	0.016-	0.100**	1			
CFF	0.007	-0.463**	-0.105**	-0.039	-0.319**	1		
SIZE	0.104**	0.053	-0.005	0.034	-0.114**	0.062	1	
LEV	-0.676**	-0.250**	0.178**	0.286**	0.181**	-0.022	0.130**	1

99% *, 95% *

3.1. Testing H1
Results of testing first hypothesis are as follows:

Table 5: Results of testing first hypothesis

Variables	ROA		
	(Coefficient)	(t-Statistic)	Prob.
CFO	-0.026	-0.653	0.514
SIZE	0.013	5.598	0.000
LEV	-0.340	-22.445	0.000
C	0.136	4.072	0.001
R Squar	0.495		
Adjusted R Square	0.492		
Durbin-Watson	1.918		
F	224.29	**Prob.** 0.000	
Godfrey	0.765	**Prob.** 0.465	
F-white	4.545	**Prob.** 0.000	
F-limer	0.877	**Prob.** 0.477	

Based on results of the test represented in table 5, the meaningfulness level of F-Limer statistic shows that pooled data method is preferred one compared to panel data method. Also the meaningfulness level of F-White statistic represents that the regression has divergent variance. Thus, after removing standard error and variance divergence, the adjusted regression is calculated as the table above. In the next stage and regarding that F statistic has a meaningfulness level of below 5 percent, the regression has the description power. Also since the meaningfulness level of cash flows resulting from operational activities in dependent variable of return of asset is more than 5 percent, it can be said that cash flows resulting from operational activities do not have a meaningful effect on return of assets Also firm size and financial leverage have significant effect on return of asset. Durbin-Watson statistic is between 1.5 and 2.5. Thus, we can conclude that there is not self-correlation problem between the variables. Finally the amount of identification coefficient shows that changes in independent and control variables have resulted in changes in dependent variables of return on assets amounting to %49.5, respectively.

3.2. Testing H2

Table 6: Results of testing second hypothesis

Variables	ROA		
	(Coefficient)	(t-Statistic)	Prob.
CFIR_SF	-0.549	-5.566	0.000
SIZE	0.012	6.630	0.000
LEV	-0.316	-23.116	0.000
C	0.091	3.298	0.001
R Square	0.568		
Adjusted R Square	0.566		
Durbin-Watson	1.981		
F	301.54	**Prob.** 0.000	
Godfrey	0.018	**Prob.** 0.982	
F-white	30.556	**Prob.** 0.000	
F-limer	1.119	**Prob.** 0.345	

Based on results of the test represented in table 6, the meaningfulness level of F-Limer statistic shows that pooled data method is preferred one compared to panel data method. Also the meaningfulness level of F-White statistic represents that the regression has divergent variance. Thus, after removing standard error and variance divergence, the adjusted regression is calculated as the table above. In the next stage and regarding that F statistic has a meaningfulness level of below 5 percent, the regression has the description power. Also since the meaningfulness level of cash flows resulting from return of investments and interest paid to finance in dependent variable of return of assets is less than 5 percent, it can be said that cash flows resulting from return of investments and interest paid to finance have a negative and meaningful effect on return on

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assets. Also firm size and financial leverage have significant effect on return of asset. Durbin-Watson statistic is between 1.5 and 2.5. Thus, we can conclude that there is not self-correlation problem between the variables. Finally the amount of identification coefficient shows that changes in independent and control variables have resulted in changes in dependent variables of return on assets amounting %56.8, respectively.

3.3. Testing H3

Table 7: Results of testing third hypothesis

Variables	ROA		
	(Coefficient)	(t-Statistic)	Prob.
PT	-1.530	-8.734	0.000
SIZE	0.013	6.236	0.000
LEV	-0.307	-19.747	0.000
C	0.092	3.162	0.001
R Squar	0.545		
Adjusted R Square	0.543		
Durbin-Watson	1.933		
F	274.37	**Prob.** 0.000	
Godfrey	0.313	**Prob.** 0.730	
F-white	3.950	**Prob.** 0.000	
F-limer	1.549	**Prob.** 0.186	

Based on results of the test represented in table 7, the meaningfulness level of F-Limer statistic shows that pooled data method is preferred one compared to panel data method. Also the meaningfulness level of F-White statistic represents that the regression has divergent variance. Thus, after removing standard error and variance divergence, the adjusted regression is calculated as the table above. In the next stage and regarding that F statistic has a meaningfulness level of below 5 percent, the regression has the description power. Also since the meaningfulness level of cash flows resulting from paid income tax in dependent variable of return on assets is less than 5 percent, it can be said that cash flows resulting from paid income tax have a negative and meaningful effect on return on assets. Also firm size and financial leverage have significant effect on return of asset. Durbin-Watson statistic is between 1.5 and 2.5. Thus, we can conclude that there is not self-correlation problem between the variables. Finally the amount of identification coefficient shows that changes in independent and control variables have resulted in changes in dependent variables of return on assets amounting %54.5, respectively.

3.4. Testing H4

Table 8: Results of testing fourth hypothesis

Variables	ROA		
	(Coefficient)	(t-Statistic)	Prob.
CFI	-0.096	-1.921	0.049
SIZE	0.012	5.296	0.000
LEV	-0.334	-21.923	0.000
C	0.136	4.094	0.000
R Squar	0.498		
Adjusted R Square	0.496		
Durbin-Watson	1.905		
F	227.042	**Prob.** 0.000	
Godfrey	0.847	**Prob.** 0.429	
F-white	4.175	**Prob.** 0.000	
F-limer	0.863	**Prob.** 0.485	

Based on results of the test represented in table 8, the meaningfulness level of F-Limer statistic shows that pooled data method is preferred one compared to panel data method. Also the meaningfulness level of F-White statistic represents that the regression has divergent variance. Thus, after removing standard error and variance divergence, the adjusted regression is calculated as the table above. In the next stage and regarding that F statistic has a meaningfulness level of below 5 percent, the regression has the description power. Also since the meaningfulness level of cash flows resulting from investment activities in dependent variable return on assets is less than 5 percent, it can be said that cash flows resulting from investment activities have a negative and meaningful effect on return on assets. Also firm size and financial leverage have significant effect on return of asset. Durbin-Watson statistic is between 1.5 and 2.5. Thus, we can conclude that there is not self-correlation problem between the variables. Finally the amount of identification coefficient shows that changes in independent and control variables have resulted in changes in dependent variables of return on assets amounting to %49.8, respectively.

3.5. Testing H5

Table 9: Results of testing fifth hypothesis

Variables	ROA		
	(Coefficient)	(t-Statistic)	Prob.
CFF	-0.026	-0.653	0.514
SIZE	0.013	5.598	0.000
LEV	-0.340	-22.445	0.000
C	0.136	4.072	0.000
R Squar	0.495		
Adjusted R Square	0.492		
Durbin-Watson	1.918		
F	224.292	**Prob.** 0.000	
Godfrey	0.765	**Prob.** 0.465	
F-white	4.545	**Prob.** 0.000	
F-limer	0.877	**Prob.** 0.477	

Based on results of the test represented in table 9, the meaningfulness level of F-Limer statistic shows that pooled data method is preferred one compared to panel data method. Also the meaningfulness level of F-White statistic represents that the regression has divergent variance. Thus, after removing standard error and variance divergence, the adjusted regression is calculated as the table above. In the next stage and regarding that F statistic has a meaningfulness level of below 5 percent, the regression has the description power. Also since the meaningfulness level of cash flows resulting from financing activities in dependent variable of return on assets is less than 5 percent, it can be said that cash flows resulting from financing activities do not have a meaningful effect on return on assets. Also firm size and financial leverage have significant effect on return of asset. Durbin-Watson statistic is between 1.5 and 2.5. Thus, we can conclude that there is not self-correlation problem between the variables. Finally the amount of identification coefficient shows that changes in independent and control variables have resulted in changes in dependent variables of return on assets amounting to %49.5, respectively.

4. Conclusion and suggestions

The goal of doing the present research was to study the effect of components of cash flow statement on management Performance in firms enlisted in Tehran Stock Exchange. Research findings showed that effect of cash flows resulting from operational activities on return on assets is meaningless. Maybe we can say that current assets of the company were inefficient and lack enough ability to achieve return. Cash flows resulting from return on investment and interest paid to finance affect return on assets negatively. The reason is that in Iran, most companies finance through borrowing and these borrowings are carried out either through stockholders or getting loans from the banks. Therefore, the interest and earning paid for the stock will be more than interest and earnings received. Since interest cost and earning payment have reverse relationships with earnings, their increase will result in earnings reduction. On the other hand, due to the greater amount of output flow of cash compared to its input, liquidity will reduce and this will limit activities such as investment and earnings' achievement. Cash flows resulting from paid income tax affect return on assets negatively. This is due to the fact that tax is the transfer of a portion of the income of a business unit to the government or giving a part of the earnings of economic activities by the companies which is got by the government because it is the government that has prepared the facilities to achieve income and earnings. Therefore, the more tax being paid means that a greater portion of earning has been appropriated to the government and this will reduce earning and the ratios of return on assets. Besides that, the more increases in these cashes, the more will be drawn out of the company and cash resources needed for investment and achieving more return will be limited. Cash flows resulting from investment activities affect both return on assets negatively. The

reason of the result achieved can be explained in two ways. One is that the investments carried out in firms under investigations have not been efficient appropriately or cash flows resulting from sales and conferring more investments that cash flows resulting from the purchase of investments through which the cashes resulted were not consumed for reinvestment. And they have been consumed in other cases except investment, such as the repayment of liabilities. Another explanation is that most investments carried out by the companies under investigations were of long-term types which were in their primary stages and their recovery by the companies will be done during the years after this research period is over.

Cash flows resulting from financing activities did not have any progressive or regressive effects on return on assets because financing affects earnings in two ways. One is through interest cost and stock earnings related to t whose effect will be reflected through part 2 of cash flow statement, namely, return of investments and earnings paid to finance. And the other one is that when the supplied resources are spent for investment its effect will affect cash flow statements of earnings through part 4. Thus, we can say that financing through other parts will reflect their own effect, and as a whole net cash flows resulting from financing affect only cash flows and not the earnings. Therefore, it does not have any effect on return on assets.

4.1. Suggestions

- **Investors:** regarding the results of this research it can be suggested that the investors should pay more attention to cash flows statements when they make decisions for investment. Not only it should be investigated to recognize cash flow of the company, but all components of it and the reasons resulting in increasing and decreasing their cash flows to be investigated completely and its effect on earnings and also the operations of oneself to invest was measured.

- **Managers:** regarding the fact that the goal of managers is to deserve the trust of owners. Thus, they should consider this issue that one of the most important tools for deserving this trust is reports that transfers through financial statements. Therefore, financial statements such as cash flows statement are highly important and the management should try to observe transparency and increasing information content , should present it in a way that users not only are helped in assessing cash flows, but also in performance assessment.

- **The committee for devising accounting standards:** it can be suggested to FASB that due to the highly importance of cash flow statements in statements of the model or methods which lead to the presentation of financial statements with more reliability and transparency and also higher information content. They should have deeper effects on decision making by he users. They studied those models and use alternative models utilized.

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